Class Actions as a Regulatory Instrument

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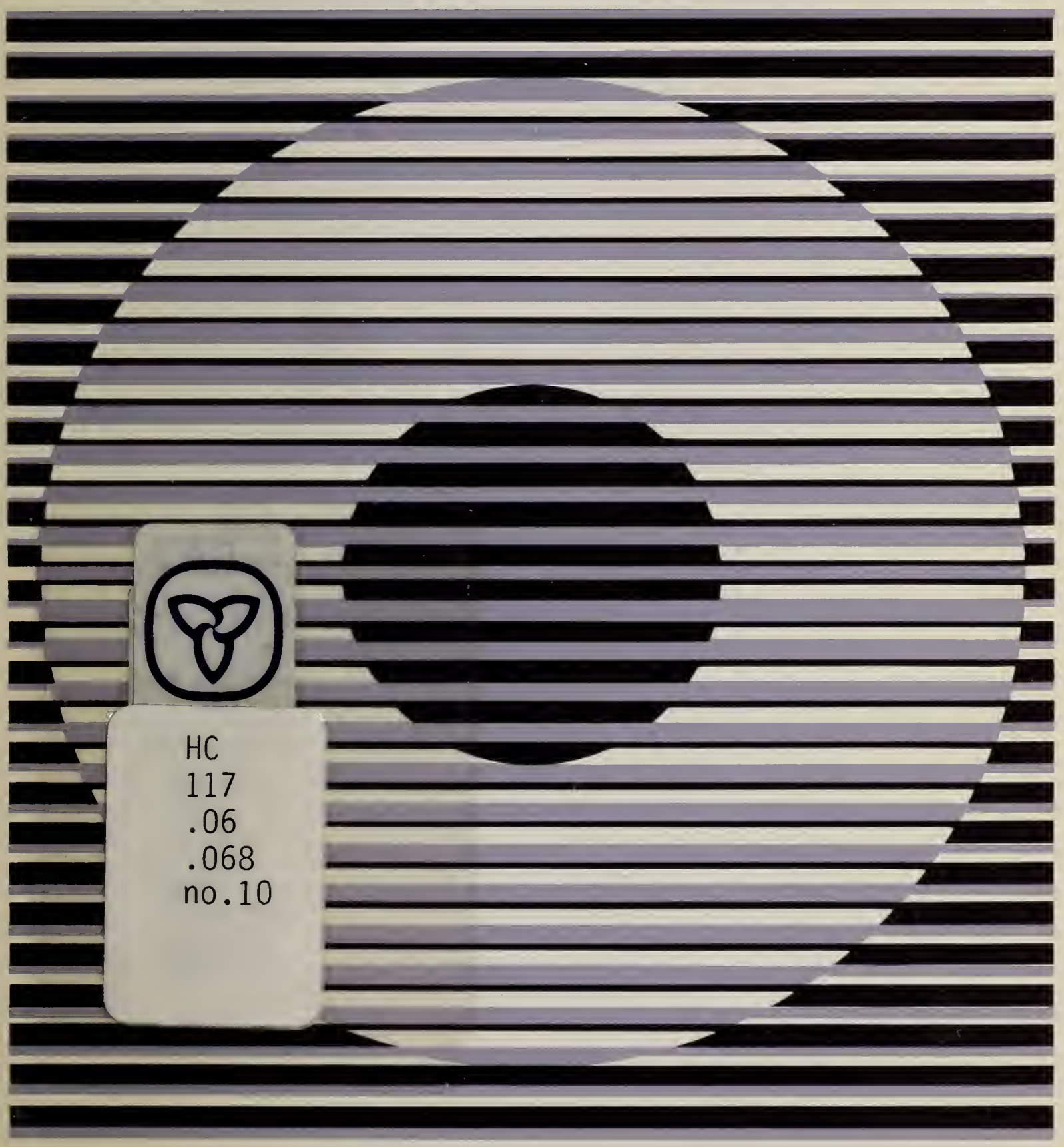

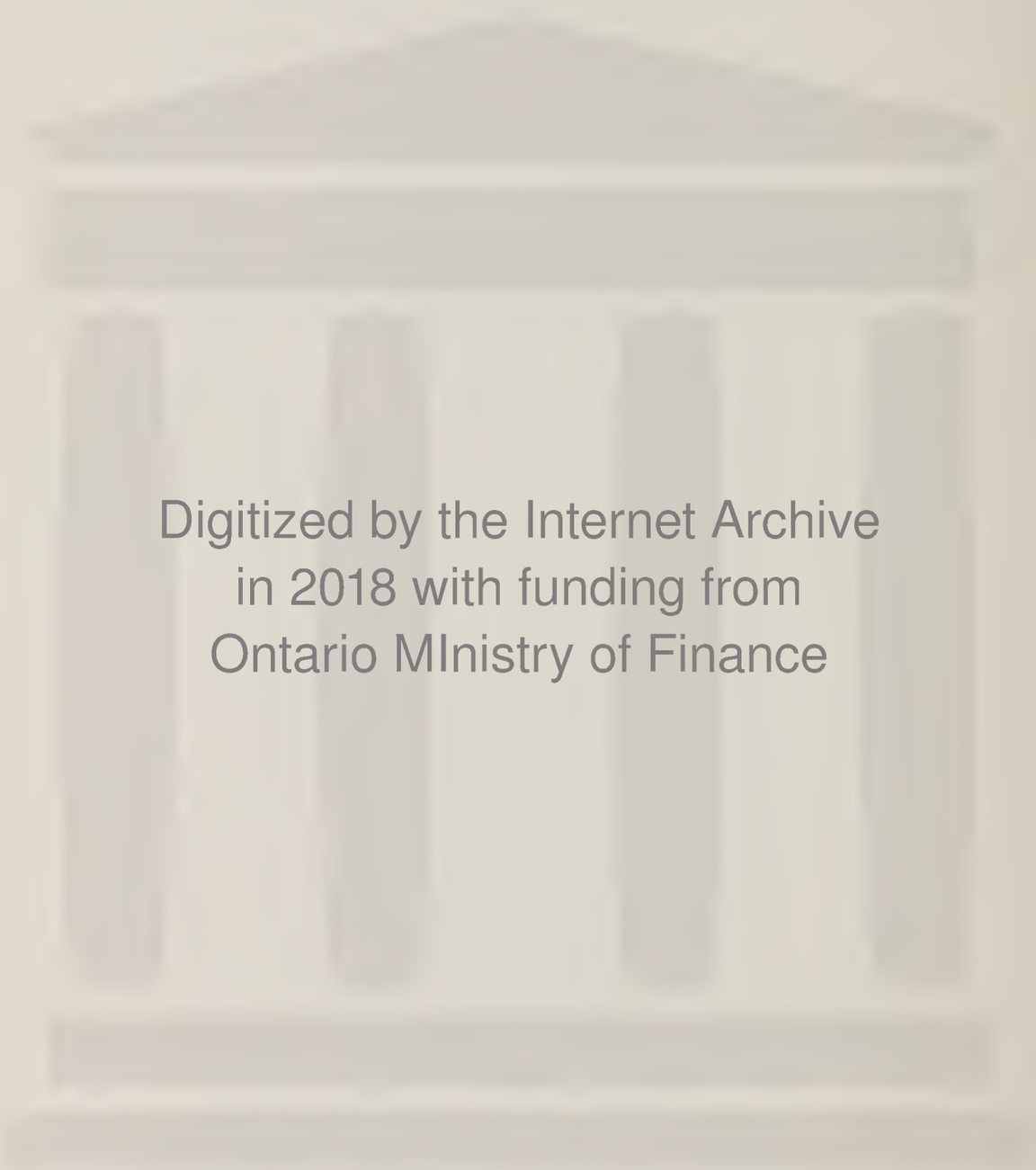

CLASS ACTIONS AS A REGULATORY INSTRUMENT

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INTRODUCTION

Regulation may take many forms, but it is usually a means by which society, through government agencies, alters the behaviour of individuals, groups, or organizations. There are other ways to alter behaviour than direct regulation. Private lawsuits are a means of both redressing some grievances and controlling behaviour - deterring behaviour that might subject one to a lawsuit. The private lawsuit can therefore substitute in some ways for direct regulation. The simultaneous use of direct regulation

This paper is based in part on previous work by the authors: see Prichard and Trebilcock, 'Class actions and private law enforcement,' (1978), 27 U.N.B.L.J. 5; Prichard, 'Private enforcement and class actions,' Chapter 9 in Prichard, Stanbury, and Wilson, Canadian Competition Policy: Essays in Law and Economics (1979); Trebilcock et al., A Study on Consumer Misleading and Unfair Trade Practices (Information Canada, 1976); Dewees, 'The court and economic regulation,' in Friedland, Courts and Trials (1975) 119.

Canadian writing to date on class actions has not been substantial. The following published articles are the major sources: Kazanjian, 'Class actions in Canada,' (1974), 11 Osgoode Hall L.J.; Williams, 'Consumer class actions in Canada - some proposals for reform,' (1974), 13 Osgoode Hall L.J. 1; Sherbaniuk, 'Actions by and against trade unions in contract and tort,' (1958), 12 U.T.L.J. 151; Reid, 'Class actions: deterrence, redress or legal nightmare,' in Rowley and Stanbury, Competition Policy in Canada: Stage II, Bill C-13 (1978), 205; Ziegel, 'The future of Canadian consumer class actions,' (1974), 32 Advocate 286; A Proposal for Class Actions Under Competition Policy Legislation (Information Canada, 1976); Prichard and Trebilcock, supra; Trebilcock, supra; Prichard, supra.

The relevant US literature includes: Breit and Elzinga, 'Antitrust enforcement and economic efficiency: the uneasy case for treble damages,' 17 J. Law and Econ. 329 (1974); Breit and Elzinga, 'The instruments of antitrust enforcement,' 23 Emory L.J. 943 (1974); Breit and Elzinga, 'Antitrust penalties and attitudes towards risk: an economic analysis,' 86 Harvard L. Rev. 693 (1973); Elzinga and Breit, The Antitrust Penalities (1976); Dam, 'Class actions: efficiency, compensation, deterrence and conflict of interest,' 4 J. Leg. Studies 47 (1975); Landes and Posner, 'The private enforcement of law,' 4 J. Leg. Studies 1 (1975); Mashaw, 'Private enforcement of public regulatory provisions: the citizen suit,' 4 C.A.R. 29 (1975); Becker and Stigler, 'Law enforcement, malfeasance and compensation of enforcers,' 3 J. Leg. Studies 1 (1974); Becker, 'Crime and punishments: An economic approach,' 76 J. Pol. Econ. 169 (1968); Stigler, 'The optimum enforcement of laws,' 78 J. Pol. Econ. 526 (1970); Posner, 'An economic approach to legal procedure and judicial administration,' 2 J. Leg. Studies 39 (1973); Crumplar, 'An alternative to public and victim enforcement of the federal securities and antitrust laws: citizen enforcement,' 13 Harvard J. Legis. 76 (1975); Posner, Economic Analysis of Law (2nd ed., 1977).

and private lawsuits can be observed in many areas, such as environmental pollution, consumer protection, labour relations, competition law, and securities regulation. One special form of private lawsuit, the class action, is examined in this paper as, among other things, a means of affecting behaviour in place of direct regulation.

Besides seeing the class action as an instrument of regulation, this paper analyses it as an alternative to public enforcement of regulatory standards. That is, even when a collective decision sets appropriate rules of conduct, the issue whether these rules should be enforced by public or private prosecutions remains. In this context the private class action is a variant of private prosecution that merits consideration as an alternative to public enforcement actions.

A class action is a lawsuit brought by an individual, the class representative, on behalf of himself and all other persons similarly situated, who constitute the class. The class members must have a common interest and a common grievance. For example, if the value of a product is significantly reduced because of a design defect that could not be known to the buyer, one purchaser might bring a class action suit against the manufacturer on behalf of himself and all other purchasers of the product. In this single lawsuit the rights of all purchasers with respect to the alleged design defect could be decided, rather than flooding the courts with thousands of individual claims or leaving the purchasers with no recourse if their individual losses were too small to warrant taking legal action. If the class suit is successful the damages paid by the defendant are distributed to the class members. An injunction may also be issued prohibiting further sales of the defective good.

A class action is not the only means of bringing together in a lawsuit several parties with a common interest. Under current Ontario rules of practice, if several lawsuits are filed contemporaneously and involve essentially the same facts and issues, the court can order them to be joined and heard together to economize on court resources and the time of witnesses. However, joinder has significant limitations as a mechanism for litigating numerous individual claims in a single proceeding; the class action thus has the greatest potential.

Rule 75 of the Ontario Rules of Practice, governing class actions in Ontario, provides: 'Where there are numerous persons having the same interest, one or more may sue ... for the benefit of all.' The interpretation of this rule has been sufficiently restrictive that such suits are rarely

brought. Class actions have been barred where the class members had separate contracts with the defendant and where damages would have to be assessed separately for each member. In addition, the rules governing the payment of costs and legal fees in Ontario are such that a class representative would usually be better off bringing an action only on his own behalf and not on behalf of the class. This contrasts with the situation in the United States where the interests of the class members may be much more diverse and where the rules governing costs and legal fees do not seriously discourage the class representative from bringing an action in class rather than individual form. It has been suggested that the US rules, including contingent fee awards, may actually encourage litigation generally and class litigation in particular.

Recently there has been pressure to expand the availability of class action procedures in Ontario by groups or individuals who feel that some interests cannot be protected in court under the present procedure. There is opposition from those who fear a flood of vindictive litigation. The strength of feelings on this issue can be sensed from the vigour of the past debate in the United States, which has had long experience with class actions in many areas, including the antitrust laws. Supporters have labelled the US antitrust class action 'the bulwark of antitrust enforcement' and 'the strongest pillar of antitrust,' while the class action generally has been described as 'one of the most socially useful remedies in history' and a mechanism which 'deters the robber barons from plundering the poor.'[1] Critics have called it 'legalized blackmail,' a 'Frankenstein monster,' an 'engine of destruction,' and a way to convert 'an individual cold into a national epidemic of pneumonia.'[2]

One purpose of this paper is to identify the economic issues that arise in various methods of extending class action procedures, so that the debate about these alternatives can be tempered by some understanding of their economic consequences. That there will be a debate is clear because a number of proposals have been made for modifying class action procedures both in the United States and in Canada.

1 Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134, 139 (1961); Loevinger, 'Private action - the strongest pillar of antitrust,'3 Antitrust Bulletin 167 (1958);Pollock, 41 Antitrust L.J. 230 (1972).

2 Handler, 'The shift from substantive to procedural innovations in antitrust suits - twenty-third annual antitrust review,' 71 Columbia L. Rev. 1 at 8-9 (1971). Pollock, supra, n. 1.

The recently proposed amendments to the Combines Investigation Act (Bill C-13) specifically provide for bringing class actions with respect to certain anti-competitive practices. The Quebec Class Action Bill (Bill 39, 1978) would provide public funding for some of the plaintiff's costs in a class action and expand the availability of that action. The US Uniform Class Actions Act is a model Act that state governments might adopt, while the US Senate Class Action Bill (Senate Bill S-3475, 1978) would significantly alter the federal class action procedure in the United States. The Ontario Law Reform Commission is now studying the present Ontario procedure and possible modifications to it. The issue of class action rules is thus important and timely.

This paper considers three basic questions about class actions in Ontario: Is it desirable to facilitate them? If so, to what extent? And what procedural changes would be needed to do so?

The answers to all these questions involve judgments that cannot be made solely on the basis of logic and analysis. We therefore do not produce final positive answers but attempt to identify the issues and some of the consequences of the choices that will be debated in the near future.

Because this report is written for the informed public and not solely for those lawyers and economists who have studied the problems of class action design, it avoids some of the more technical issues. It does not include an exhaustive survey of all the relevant literature and cases. Nor does it review the rapidly growing empirical literature on the experience with class actions in the United States. It merely identifies the major arguments and economic questions.

First we discuss the objectives that can be served by class action procedures and propose a framework for evaluating those procedures. Then we look at the choice between public and private enforcement of regulatory statutes and the role that class actions can play in private enforcement. Next we examine various alternative designs, pointing out that the choice is not for or against class actions but rather among a range of designs that make the use of this form of litigation either more or less attractive. Finally we summarize the specific choices that must be made and indicate some consequences of each. We hope this analysis will allow the reader to form his own opinion about the appropriateness of the alternatives that lie before us.

OBJECTIVES OF LAW ENFORCEMENT

Before discussing the objectives that might be used to evaluate modifications to class action procedures, it is useful to identify the role of class actions in litigation generally. In many areas of law we rely upon both public enforcement and private litigation to limit in the public interest wrongful activity that falls short of traditionally criminal acts. The laws governing these areas may be classified as public welfare legislation or 'social regulation,' since they deal with acts that are prohibited for the improvement of social welfare generally but are not inherently criminal. For example, the Ontario Environmental Protection Act prohibits the discharge of certain pollutants in excess of specified amounts, and the Crown can prosecute violators of this Act. In addition, a private citizen who is harmed by a pollution discharge can in some cases bring a civil action seeking compensation for the damage he has suffered and perhaps an injunction against further harmful emissions. If a firm produces a sufficiently hazardous product it may be in violation of laws governing product safety and subject to public prosecution for this activity. It may also be liable in a civil suit to those injured as a result of the product's hazardous design. The threats of both public prosecution and private civil litigation act as deterrents to wrongful activity in a wide variety of fields, such as environmental protection, product safety and quality, occupational health, restrictive trade practices, and securities regulation.

Thus there are two procedures for attacking wrongful activity. The first is public prosecution, in which the Crown prosecutes the wrongdoer for violation of a specific statute or regulation. If the prosecution is successful a fine is imposed on the wrongdoer to be paid to the state, and further wrongdoing may be prohibited. The second procedure is a private civil suit in which the victim of the wrongful activity sues the wrongdoer for the damages he suffered and perhaps for an injunction against further wrongdoing. A variation of the civil suit is a class action in which a private citizen brings a suit against the wrongdoer on behalf of himself and all other victims similarly situated. A successful class action results in damages paid by the wrongdoer and distributed to the members of the class who can be identified and contacted. An injunction prohibiting further wrongful activity may also be granted.

To evaluate the class action as a way of regulating wrongful activity we must consider the objectives of regulation.

Social regulation of the type discussed in this paper may have any of three objectives. One is to deter the wrongful activity, referred to as 'deterrence' or 'behaviour modification.' Another is to compensate those injured by that activity. Since deterrence is rarely complete, compensation may be desirable for those who are still harmed despite the attempted deterrence. Thus these objectives may sensibly be pursued together. A third objective is conflict resolution: using the legal system to achieve a peaceful settlement of a private dispute.[3] The main focus in conflict resolution is on the parties before the court and the actions that brought them there. This paper emphasizes the deterrence and compensation objectives, with only passing reference to conflict resolution, not because the latter is unimportant but because a careful treatment of it is a separate question.

An important distinction must be made between substantive and procedural law. Substantive law reflects social values by specifying what is lawful and unlawful and who is entitled to what set of rights. For example a reduction in the amount of a potentially toxic chemical that may legally be discharged into the environment is a change in the substantive law. Procedural law comprises the rules under which legal actions may be brought. Thus, relaxing the rule that class members must have identical interests may allow a wide range of victims of pollution discharge to sue as a class and enforce their clear substantive rights when they would not be able to bring separate actions because of the legal costs. A change in procedural rules may affect the form in which actions are brought and may also lead to rights being enforced that would otherwise not be enforced. In other words, though substantive law is different from procedural law, they are closely related.

This close relationship has several implications for the evaluation of procedural changes for class actions. First, if there is no effective technique for enforcing a particular substantive rule, that rule has little content. If a change in procedure renders that rule enforceable for the first time, the impact is as great as if the substantive rule had just been enacted. Thus, facilitating the enforcement of a substantive rule may lead to a serious re-examination of the substantive rule itself. Facilitating class actions in Ontario might lead to the discovery that the substantive law in a particular area was no longer reasonable, given the ability to enforce many

[3] Scott 'Two models of the civil process,' 27 Stanford L. Rev. 937 (1975).

small claims. For example, in the United States the Truth-in Lending Act provides minimum damages of $100 to be paid by a lender who fails to comply with disclosure rules regarding the terms of his loans. The appearance of class actions on behalf of thousands of credit card holders each of whom may have suffered little or no actual damage from the improper disclosure has led to consideration whether the substantive liability rule was unreasonable given the availability of class actions.[4] In Ontario Section 36 of the Consumer Protection Act specifies information that must be part of a consumer credit contract, including the interest rate calculated in a certain manner. If there is an error or omission in the contract, the legislation says it is not binding, so that the consumer might not be required to repay his debt. While this severe remedy may be appropriate where individual litigation will be rare, a different judgment might be reached if class actions could have thousands of loan contracts declared void for a trivial error in a contract form.

Second, substantive changes may be needed in some areas for a class action procedure to be useful. For example, if the substantive law requires that the victim of consumer misrepresentations must have actually relied on the misrepresentation, for example in advertisements for a commodity, then the economy to be achieved in bringing an action in class form would be substantially reduced since each member of the class would have to appear to testify to his reliance. If the class procedure is to be used effectively it may be necessary to dispense with this proof of reliance, either by statutory amendment or by judicial interpretation. We do not argue that this particular change is desirable; the point is that to extend class actions into the consumer misrepresentation area some substantive modification might be needed along with procedural changes.[5]

Having identified deterrence as an objective of regulation through both public prosecution and private actions leaves the crucial question of how much deterrence is desirable. The economist's answer to this question is found in the concept of economic efficiency. With regard to a particular type of wrongful activity, economic efficiency is achieved when all costs

[4] Ratner v. Chemical Bank New York Trust Co., 54 F.R.D. 412 (S.O.N.Y. 1972). For a discussion of this issue and case see Landers, 'Of legalized blackmail and legalized theft: consumer class actions and the substance-procedure dilemma,' 47 S. Calif. L. Rev. 842 at 886 (1974).

[5] For a preliminary discussion of this issue in Ontario, see Naken v. General Motors of Canada (1977) 17 O.R. (2d) 193 (Div. Ct.) (1979), 8 C.P.C. 232 (Ont. C.A.).

associated with that activity are minimized.[6] The costs to be considered are the cost to the wrongdoer of reducing his activity, the damage done to the victim, the victim's costs of avoiding damage, and the public and private costs of imposing deterrence, including surveillance costs, legal fees, and court costs for both plaintiff (or prosecutor) and defendant, and any other costs, economic or non-economic, that can be traced to the activity.

It should be clear that the efficient (or 'optimal') amount of deterrence will not necessarily be complete deterrence, simply because of the cost of achieving it. For example, completely eliminating harmful pollution discharge from an industry might force that industry to shut down. Balancing the costs of pollution damage against the cost of pollution control would likely lead one to choose partial control at moderate cost rather than full control at great cost. Thus, the choice of a standard of prohibited conduct should be influenced by cost-minimizing considerations. Similarly, to prevent all burglaries in a city might require a policeman stationed at every house. The cost to the taxpayers of this degree of deterrence would be so high that there would probably be unanimous support for a program of less taxes and more burglary. Thus, once a standard of prohibited conduct is adopted (burglary is unlawful) the degree of enforcement should be influenced by cost-minimizing considerations.

How can one tell if the optimal degree of deterrence has been reached? In principle one asks whether small increases or decreases in deterrence will lower the total costs, as listed above, from the activity. If some change will reduce total costs that change should be made. If an additional $1000 spent on police protection will reduce the social costs of burglary by more than $1000, then more should be spent on police protection. When the point is reached where no change can reduce total costs, the cost minimum has been reached, and the degree of deterrence is optimal.

One procedure for approaching optimal deterrence is to face the wrongdoer with the expected value of the full social cost of his wrongful activity. This is often referred to as 'cost internalization' because all the costs are taken account of in the wrongdoer's decision-making process.[7] If the wrongdoer must pay for all the damage he causes, he faces the full set of costs, and his private profit-maximizing motives will lead him to minimize

[6] See Stigler 'The optimum enforcement of law,' 78 J. Pol. Econ. 526 (1970).

[7] See Wright 'The cost-internalization case for class actions,' 21 Stanford L. Rev. 383 (1969).

those costs. It must be remembered, however, that there are costs to cost internalization, such as the costs of victims suing for damages, or the costs of administering the cost-internalization scheme. Thus even cost internalization is not always efficient. It will only be efficient when the reduced damages and reduced damage avoidance costs achieved because of cost internalization are greater than the cost of reducing those damages plus the cost of achieving the internalization itself. Thus, if the legal fees and court costs of the class action suits needed to impose on polluters the full cost of the damages they cause are sufficiently great, they might even exceed the amount of the damages themselves. In this case the cost-minimizing solution is not to achieve cost internalization but to leave the pollution undiminished or use public enforcement rather than private litigation if public enforcement consumes fewer resources than private enforcement.

To test the effectiveness of deterrence, therefore, we can apply the criterion of economic efficiency, interpreted as minimizing all costs. We know of no similar test for evaluating compensation or conflict resolution. In a full evaluation of class action choices we can discuss the efficiency of deterrence; but we can only describe the extent to which compensation and conflict resolution will be achieved and state the cost of the program, leaving the reader to decide for himself the importance of these two objectives and balance that against the cost of achieving them.

Class actions can be divided into three categories.[8] The first is 'individually recoverable.' An action is individually recoverable if the amount of the individual damage or claim is sufficiently large that the individual could bring suit on his own in the absence of a class action procedure. Since most injured parties will bring individual actions in the absence of a class action procedure, the same degree of deterrence, compensation, and conflict resolution will be achieved with or without the class action. The only effect of the class action is to consolidate numerous suits into one and thus reduce the resources consumed in litigation. The provision of an expanded class action in individually recoverable cases can thus be evaluated on the basis of the reduction in these costs that is achieved. There would appear to be no significant drawbacks to class actions here.

The second category is 'individually non-recoverable.' These include

[8] 'Developments in the law - class actions,' 89 Harv. L. Rev. 1318, at 1356 (1976).

claims that are sufficiently small relative to the possible legal costs that no individual suit would be brought. The claims are large enough, however, that if the costs of litigation are paid from the class recovery it may become economical to bring the action in class form. Once a class action is successfully completed the individual class members will be able to claim their share of the recovery. In the absence of a class action there will be no deterrence except for public prosecution and no compensation for victims of wrongs that would lead to individually non-recoverable claims. A class action procedure can in such cases provide both deterrence and compensation. It will also provide conflict resolution to the extent that class members perceive the violation of their rights and are concerned about it, a matter usually difficult to gauge. If most class members are ignorant of their rights or of the violation of them, little or no conflict resolution is provided.

The third category of claim is the 'non-viable.' These claims are so small that they would not be brought as individual lawsuits, and it is uneconomical to identify and compensate class members even if a class action suit is successful because the expense of asserting a right to a portion of the recovery is greater than the probable share of the recovery. In non-viable cases compensation is not possible, and conflict resolution may be irrelevant since the magnitude of the harm to an individual is so small that many persons may not realize that they have been harmed. The primary objective served by allowing class actions in such cases is to deter the wrongful behaviour.

Most participants in the debate over the desirability of facilitating class actions agree that they are desirable in the case of individually recoverable actions. Opponents of class action argue, however, that the number of such cases is trivial. Proponents emphasize the opportunity for achieving all three objectives in the individually non-recoverable cases, while opponents point to non-viable claims as litigation without purpose. To some extent proponents emphasize behaviour modification, for which the deterrence in non-viable cases is a positive factor. Opponents have tended to emphasize conflict resolution and compensation and therefore see little merit in non-viable actions. The volume of litigation that might arise in each category would depend in part on the cost and fee rules, which are discussed below.

PRIVATE VERSUS PUBLIC ENFORCEMENT

Introduction

Delineating the appropriate roles of public and private law enforcement mechanisms is a major task in determining an effective law enforcement strategy.[9] As a general rule the relationships and duties of private citizens to each other are regulated through private enforcement. On the other hand the public law system is designed to establish rules of conduct to protect the general social welfare and has traditionally been enforced primarily by public officials. However, this description of the respective function of private and public enforcement greatly oversimplifies the complex array and mix of law enforcement strategies to be observed in most contemporary legal systems. More and more we observe the intrusion of public enforcement mechanisms into areas traditionally conceived of as falling within the domain of private law, while at the same time areas of law traditionally thought of as falling within the domain of public law increasingly provide additional private-law-oriented sanctions.[10]

The explanation of this complex mix of enforcement strategies lies in part in the fact that compensation, traditionally a matter of private law, can achieve deterrence, traditionally a matter of criminal law. A civil law action for damages that results in an award large enough to deter offenders can substitute for criminal prosecution resulting in a fine as a means of gaining compliance with the law. From the point of view of the offender or potential offender a criminal prosecution resulting in a fine is as effective as a civil action resulting in the payment of damages;[11] the offender is required to make a financial payment that, if properly calculated, can confront him with the full social cost of his activity.

[9] The analysis in this section is derived in large part from the articles cited in the opening footnote.

[10] Furthermore, there is increasing recognition that rules of conduct derived from litigation in areas of private law have a general regulatory effect in addition to resolving the particular dispute between the parties. See, for example, Posner, 'A theory of negligence,' 1 J. Leg. Studies 29 (1972).

[11] In suggesting that fines and civil damages awards are in many ways substitutes, we do not intend to suggest that there are no differences between sanctions, such as the relative stigma attached to them, the relative adverse publicity associated with them, and so on. Rather, our point is that at the margin, particularly in areas of economic regulation, the primary determinant of deterrence will be the financial penalty faced.

The result of this substitutability is that the goal of optimal enforcement described above can be sought by either public or private enforcement techniques or by a combination thereof. It is possible to imagine an optimal enforcement strategy relying exclusively on either public or private mechanisms. However, the mechanisms required to ensure optimal enforcement decisions differ substantially between public and private enforcement. In the case of public enforcement the public prosecutor is in theory in a position to achieve optimal enforcement by altering the rate of apprehension and conviction of offenders so that, when combined with the scale of financial penalties, such changes can confront offenders with expected penalties equal to the social losses they will impose. Furthermore, the public prosecutor can include the real cost of enforcement in determining the optimal enforcement strategy. While in reality public enforcement may not reach this ideal, the potential for such decision-making is inherent in the structure of public prosecution.

The achievement of optimal deterrence by private prosecutions is institutionally very different. With private prosecution the level of enforcement is set not by bureaucratic decision but by the financial incentives facing the private prosecutors. That is, private prosecutors are viewed as entrepreneurs calculating the expected revenues and costs of engaging in prosecution. The revenues are the awards of damages (or fines) achieved in successful actions, while the costs include surveillance costs for detecting offences and prosecutorial costs for bringing the alleged offenders before the court. The self-interest hypothesis of private economic activity dictates that private prosecution will occur only where the expected revenues exceed the expected costs. All else being equal, the level of private prosecutions will increase with the level of damages (or fines) recoverable and decrease as the costs of prosecution increase. Therefore, to achieve optimal enforcement through private prosecutions the level of damages (or fines) recoverable by the private prosecutors must be set so that the expected marginal revenues are just equal to the marginal costs of enforcement incurred at the optimal level of enforcement. While in theory this task is not impossible, difficulties arise that may lead to either over-enforcement or underenforcement.[12]

[12] The leading article on the problem of overenforcement is Landes and Posner, 'The private enforcement of law,' 4 J. Leg. Studies 1 (1975). Their thesis is criticized in Polinsky, 'Private versus public enforcement of fines' (mimeograph, 1978). Both articles build on the

Overenforcement results from the dual function of the level of damages or fines. From an enforcement point of view, the financial penalty for optimal enforcement should minimize the sum of the cost of enforcement plus the social cost of the harmful activity. That is, if the financial penalty is set relatively high the probability of detection and conviction can be set relatively low while maintaining the same expected penalty facing the offender and thus saving enforcement resources. From the private prosecutor's point of view, however, a higher level of financial penalty is seen as a signal to increase prosecution since the expected revenues from it have been increased. The higher penalty will lead to more private prosecution, thus shifting upwards the probability of enforcement and therefore increasing the expected financial penalty facing offenders above the optimal level. The increased financial penalty thus causes greater prosecution, although its purpose is to do the opposite; the result is overenforcement.

This problem is not insurmountable. It is possible to devise a scheme in which only a portion of the financial penalty would be paid to the private prosecutor, with the rest being paid to the Crown. Under this arrangement, by varying the portion paid to the private prosecutor the penalty could be raised without increasing the expected revenues available to the prosecutors and thus not altering the level of enforcement activity. The difficulty with this solution is that it creates an incentive for the offender and the private prosecutor to make a private settlement beyond the scrutiny of the Crown because there is a mutually profitable deal to be made. By agreeing to pay something more than the portion of the fine payable to the private prosecutor but something less than the total fine including the portion payable to the Crown, the offender and the private prosecutor make themselves better off while undermining the government's ability to set a higher level of expected penalty.

The case of underenforcement arises in two ways. First, the offender may not be able to pay the financial penalty. Particularly where it is set as a multiple of the offender's gain, but even where it only equals the gain, the offender, by the date of conviction, may not have the resources to pay the fine. In this event the private prosecutor's expected revenues are reduced, and the level of enforcement activity can be expected to decline.

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theory first presented in Becker and Stigler, 'Law enforcement, malfeasance, and the compensation of enforcers,' 3 J. Leg. Studies 1 1974). For underenforcement see Polinsky, supra, for a detailed analysis of underenforcement.

The second case of underenforcement arises in a sense from the success of prosecution. If offenders are faced with an expected penalty equal to their potential gain, one would anticipate a substantial degree of deterrence and thus a reduction in the number of successful prosecutions with a corresponding decrease in the revenues of private enforcers. While this situation may be attractive from an enforcement point of view, it is unlikely to be sustained if the private prosecutors are no longer able to anticipate an excess of revenues over costs. This excess is least likely to occur where the surveillance costs (as opposed to the prosecutorial costs) are relatively large and the damages inflicted substantial.[13]

An analytical framework

1 Introduction

We assume that from a wrongdoer's point of view the primary determinant of wrongful activity is the expected financial penalty he faces for his wrongdoing regardless of whether this financial payment is characterized as a fine or as civil damages and regardless of whether it is payable to the Crown or to private individuals. Therefore, fines and civil damages, whether collected by public or private actions, can be seen as substitute mechanisms for achieving deterrence. When the Crown brings an action it normally attempts to collect a monetary payment in the form of a fine.[14] Less frequently, the Crown may proceed by means of a civil action for damages to recover compensation for injuries done to the Crown's interests. In particular, this may arise where the Crown's land or water rights areinjured by pollution. A third form of action by the Crown is known as a parens patriae action, which is a civil action brought by the Crown to recover damages for injuries done to individuals within its jurisdiction.[15] These damages can

[13] Polinsky, supra, note 12.

[14] In some prosecutions the Crown may seek a term of imprisonment rather than, or in addition to, a fine. Our analysis ignores this possibility, although it may sometimes be relevant in certain 'underenforcement' situations (see Polinsky, supra, note 12). However, in the usual areas of social regulation - antitrust environmental law, safety and information regulation, etc. - terms of imprisonment are rarely, if ever, sought.

[15] For an introduction to parens patriae suits, see Olliff, 'Parens Patriae antitrust actions for treble damages,' 14 Harv. J. Legis. 328 (1977); Malina and Blechman, 'Parens Patriae suits for treble damages under the antitrust laws,' 65 Nw. U.L. Rev. 193 (1970); Curtis, 'The checkered career of Parens Patriae: the state as parent or tyrant,' 25 DePaul L. Rev. 895 (1976); 'The proposed antitrust Parens Patriae Act:

then be distributed to the individuals as compensation for their losses or paid into the Crown's consolidated revenue fund.

Private individuals may also bring a number of types of enforcement actions, each confronting the wrongdoer with a financial penalty. The most common form of private enforcement is an individual damages action to recover compensation for injuries suffered by the individual. The second form of private enforcement is a class action, which aggregates the individual claims of numerous individuals and litigates them in a single cause of action. The third form occurs where a private individual initiates a prosecution resulting in a fine, normally payable to the Crown, although some statutes create incentives for private enforcement by providing for payment of at least part of the fine to the individual who initiates the prosecution.

The following discussion compares only the public criminal action resulting in a fine and the private class action; this restriction is merely to simplify the analysis and not to ignore the various forms of public and private enforcement mechanisms. Indeed, it will be argued below that a form of action combining aspects of both public and private enforcement may be the most effective mechanism for a particular range of cases. In considering the attributes of the private class action we do not limit the analysis to class actions at present brought in Ontario since the existing rules virtually prohibit litigation in class form. Rather, for purposes of comparison we hypothesize a viable class action procedure the details of which are discussed later.

The public criminal action and the private damages action in individual or class form are substitutes to the extent that the calculation of the fine or damages and the frequency of the actions can be varied to meet the requirements of the optimizing enforcement calculus. It is therefore useful to consider some of the relative efficiencies of public and private prosecutions from a deterrence perspective. One can then add other considerations - compensation, prosecutorial discretion, institutional limitations, and potential for abuse - to complete the comparison of the two methods of enforcement.

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overdue antitrust relief for ultimate consumers,' 45 U. Cin. L. Rev. 219 (1976); Proposed Revisions in Federal Class Damage Procedures (a commentary on S. 3475), prepared by the Assistant Attorney General, United States Department of Justice, (mimeograph, 25 August 1978).

2 Definitions

For analytical purposes it is useful to distinguish two kinds of private enforcement actions and three types of class actions. A private civil action can be brought without any prior criminal prosecution or conviction; this is an 'independent' action. Alternatively, it can be brought following a successful criminal prosecution, in which case the fact of that conviction may in some circumstances be relied upon as creating a presumption that the offence was committed; this is a 'piggyback' action.[16]

Independent civil actions increase the probability that a defendant will be subjected to a financial penalty (in the form of a damages award) for a particular wrongful activity. A piggyback civil action merely increases the total financial liability of the defendant. In the language of the criminal law, the independent action increases the probability of conviction, while the piggyback action can only increase the level of fine.

The three types of class actions were defined above in terms of the types of individual claims they aggregate: the non-viable, the individually non-recoverable, and the individually recoverable.

3 Efficiencies of private versus public enforcement

Introduction. The relative efficiency of private and public enforcement can be analysed in three areas: investigation, prosecution, and penalties. It is important first to dismiss the notion that private enforcement is in any way free. Although it is true that if incentives are created for private enforcement an increase in the total resources devoted to enforcement activities can be achieved without any increase in the public enforcement budget, the costs of private enforcement must still be paid. When the lawyer's fees are paid on a pro rata basis by class members the enforcement costs are met by a tax on class members instead of the general public. When the fees are

[16] See, for example, the provisions of s. 31.1 of the Combines Investigation Act. However, the general rule at common law as expressed in Hollington v. Hewthorn, [1943] 2 All E.R. 35, excludes prior convictions as evidence of the facts in issue in a subsequent civil proceeding. However, the rule in Hollington v. Hewthorn has been the subject of considerable attack and reform in recent years. It has been reversed by statute in England, Alberta, and British Columbia and partially reversed by statute in Saskatchewan. Furthermore, the Law Reform Commission of Canada in its Report on Evidence (1975) recommended its reversal in this context. The Ontario Law Reform Commission has taken the opposite position (with some modification) in its Report on the Law of Evidence (1976).

paid by the offender the enforcement costs are met by a combination of increased product prices and lower returns to owners of the business. Further, private enforcement uses judicial resources so that it becomes necessary either to increase funding to maintain the existing level of service or to lengthen the waiting period for other private or public actions.

Investigative efficiencies. Some, but not all, of the characteristics of the investigative process favour public enforcement. First, there are probably returns both to scale and specialization associated with a single enforcement agency. Secondly, only a public enforcement agency is likely to be entrusted with the wider investigative powers necessary for effective scrutiny of possible misconduct. Thirdly, public enforcement does not suffer from the problem of appropriability inherent to private enforcement when a number of private enforcers are spending resources investigating a possible offence and each runs the risk that some other private enforcer will file a civil action first and thereby appropriate all the rewards since rewards are provided through the court-awarded lawyers' fees following a successful suit or settlement.[17] This competition to file first to gain the private benefits of investigation results in a bias towards the early filing of poorly investigated claims and away from the necessary investment and investigative activities. On the other hand private enforcers will often be parties to the transactions in question and thus may be better able to detect and have stronger incentives to identify violators.

Prosecutorial efficiencies. Public enforcement is favoured by the fact that no proof of damages is required. In some cases this will be a significant advantage, in others not. For example, in a price-fixing case, damages may be fairly readily proved, whereas in a misleading advertising case an assessment of damages is likely to involve each member of the class proving reliance on the misleading advertisement.

Private enforcement is favoured by the fact that the lower civil standard of proof applies (proving by a preponderance of the evidence rather than beyond a reasonable doubt), which in turn may increase the 'conviction' rate and lead to less restrictive interpretations by the courts of impeachable types of conduct than tend to obtain in a criminal proceeding.

Efficiencies of sanctions. In theory, fines imposed through public enforcement mechanisms are the ideal form of correction. They can be set to

[17] Posner, Economic Analysis of Law (1972), 378-9.

reflect the fact that conviction is not a certainty, whereas damages are limited to the damage suffered and cannot generally take account of the 'conviction' rate. Again, publicly enforced fines avoid the need to prove the amount of damage caused by the violation in the way that damages in civil suits must be proved. Finally, fines avoid any costs of distributing the penalty, whereas damages can be expensive to distribute to individual members of the class.

Two particular problems warrant attention with regard to sanctions. The first is the problem of 'perverse incentives,' that arise when the penalty is paid to the victim.[18] The problem is encountered where the financial payment is some multiple of the damage actually done, reflecting the fact that the probability that the payment will be required is less than certainty. The effect of this, at least in the case of financial injury, is that the 'victim' is likely to receive considerably more in damages than he has in fact suffered in real losses. Thus, an incentive may be created to be a victim in certain situations since, by suffering a loss, some multiple of that loss can be recovered as damages. This is the opposite of the socially desirable behaviour where potential victims act to minimize damages.[19]

The second problem with the efficiencies of sanctions arises where a portion of the total damages award claimed by the representative plaintiff on behalf of all class members remains unclaimed. In these situations the court may use the 'fluid class recovery' (also known as cy-pres) concept to distribute the residue and avoid the reduction in the deterrent effect of the award that would occur if the unclaimed damages were returned to the defendant.[20] This concept requires the court to fashion a surrogate class resembling as closely as possible the persons initially entitled to recover and then to make an order that will benefit that class. For example, if telephone subscribers were overcharged for two years and an action were brought in class form to recover damages for all telephone subscribers

18 Breit and Elzinga, 'Uneasy case,' supra, opening note, 333-40.

19 The risk of this socially undesirable conduct is reduced by the existence of the doctrines of violenti non fit injuria (a person who knowingly and voluntarily assumes the risk of the harm suffered is barred from recovering damages resulting from the harm) and in pari delicto (a person who participates in or encourages the commission of an offence is barred from recovering damages resulting from the offence). However, American experience with antitrust legislation suggests that these doctrines are not a complete response to this problem.

20 See Dam, supra, opening note, 62-4.

during that period, the court might create a surrogate class of current telephone subscribers and order the telephone company to reduce its rates by $2 a month for all subscribers in the geographic area until the revenues thereby lost to the telephone company equalled the amount of the unclaimed damages.

The fluid class recovery concept has a number of limitations. The award to a surrogate class is not as equitable as an award to the parties actually harmed. Furthermore, the price reduction will encourage greater use of the product, thus distorting resource allocations. In addition, while administering a fluid class recovery scheme may be less taxing on judicial resources than identifying every individual entitled to recover a share of the damages, it is still likely to use substantially more judicial resources than would be required if the damages were simply paid to the Crown.

Summary of efficiency considerations. In summary, numerous efficiency considerations favour public enforcement; the economies of scale in some types of investigation, the superior investigative tools, the absence of problems of appropriability of the fruits of investigation, and the simplicity and flexibility of the fine all represent efficiency advantages of public enforcement. Private enforcement is hindered by the requirement that damages be proved,[21] by the costs of distributing the damages award, and by the limitation of the damages award to the amount of damages actually suffered. In addition, attempts to use multiple damages awards or fluid class recovery face other inefficiencies.

However, private enforcement has efficiency advantages in some forms of investigation. More important, the lower standard of proof and the civil instead of the criminal nature of the private action can be expected to lead to considerably greater success rates through private enforcement and thus to significant efficiency gains. A final qualification of the efficiency of private enforcement is that to the extent private actions follow successful public prosecution, that is, to the extent they are piggyback actions, their contribution to optimal enforcement is limited to an increase in the total penalty, a result it may be possible to achieve more efficiently by a simple increase in the original fine.

[21] It should be conceded that if fines are to be calculated to reflect the social cost of the offence the calculation of this amount may not be significantly easier than proving damages. However, techniques including statistical sampling and economic modelling might be used in the fining process where their use might be difficult to reconcile with the traditional proof-of-damages process.

Although the relative efficiency of public and private methods should influence the decision on how to allocate the enforcement function, at least four other factors should also be given prominence: compensation, prosecutorial discretion, institutional limitations on public enforcement, and opportunities for abuse.

4 Compensation

The conventional justification for a civil right of action is its compensatory rather than its deterrence objective, and certainly the value of private action as a means of achieving equity through compensation should not be disregarded. However, to achieve equity is not costless, so that its value must be weighed against the cost of achieving it.

To weigh the relative advantages of public and private prosecution one must consider separately the three types of claims. For non-viable claims compensation is unachievable and cannot be given any weight at all. For individually recoverable claims compensation is dominant and will be obtained regardless of the availability of the class action; the class action is simply an efficient way of obtaining it, and any decision to discourage the use of class actions for this type of claim would clearly be inefficient.

The difficult case is the aggregation through class procedures of individually non-recoverable claims.[22] In this situation the class action procedure provides a forum for the realization of substantive rights which would otherwise be unattainable because of the procedural costs. This causes analytical difficulty, because if the 'output' of the judicial system is assumed to be fixed, at least in the short run, these newly facilitated claims will compete for priority with individual actions for which the expected benefits presumably exceed the expected costs. Since access to the courts is rationed not by pricing but by queuing, the waiting time will probably increase, and at the margin some suits which would otherwise be brought will be discouraged. Unfortunately there is no easy way to compare the social benefits of the class actions so faciliated with those of the delayed or abandoned actions. Any comparison must consider not only efficiency but also the compensation, deterrence, and other benefits of the respective actions. All that can be said with certainty is that there is no reason to assume that the newly facilitated class damages action should be given the lowest ranking in terms of social benefits. Indeed, to the extent

[22] See Dam, supra, opening note, for an attempt to resolve this issue.

that these suits successfully claim large damage awards and thereby achieve significant deterrence goals, they should be ranked relatively high, despite the fact that the aggregate claims are individually non-recoverable.

5 Prosecutorial discretion

One implication of allowing private actions, and thus breaking the public enforcement agency's monopoly on the decision of whether or not to bring an enforcement proceeding, is the loss of prosecutorial discretion.[23] This loss, of course, may be desirable if the enforcement authorities are complacent or improperly motivated, but it may be less desirable, particularly in areas of complex economic regulation, where the exercise of discretion in particular cases may represent the legitimate weighing of wider enforcement strategies and priorities and the advancement of broader economic objectives. Appropriate exercise of prosecutorial discretion also permits continuous marginal adjustments of policy to be made without constantly engaging further legislative time, which is likely to be impracticable.

The importance of the loss of discretion cannot be evaluated independently of the nature of the offence, the precision with which the statutory standard can be set, the distributive implications of the particular activity in question, and a variety of other factors. However, this certainly does not mean that private actions should be barred at the outset, though it may imply that some procedure should be developed by which the public prosecutor in certain cases would have the right to intervene and assume responsibility for the carriage of the action. This would be analogous to the existing provisions with regard to certain offences under the Criminal Code, where the provincial Crown is under an obligation to intervene in any indictable matter initiated by a private party.[24] Once the public prosecutor has intervened in criminal proceedings he is free to act as he sees fit, even to suspend prosecution of the case. Some provision similar to this may be appropriate as a control on private class actions to reserve to the public prosecutor the final authority for the enforcement of certain kinds of statutes. For example, one possible means of maintaining the necessary prosecutorial discretion while keeping a broadly defined private right of action would be through granting the public prosecutor the right to intervene in a private class action to obtain the termination of any action he

23 See Mashaw, supra, opening note.

24 Criminal Code, R.S.C. 1970, c. 34, s.2; Crown Attorney's Act, R.S.O., 1970, c. 101, s. 12(d).

might deem contrary to the public interest. Although this right would be open to possible abuse, such abuse would be limited by the fact that the prosecutor would be required to present his reasons for seeking the termination, and these reasons would be open to scrutiny by the press, the public, and the legislature.

At a minimum, it might be argued that the public prosecutor should be given the right to appear at any stage in a private class action and present to the court his views on the case. This would ensure that at least some attention would be drawn to any perceived divergence of the private and public interest. The difficulty with such provision is that it forces the court to balance competing public policies of a general socioeconomic nature without legislative direction. It might well be thought that this explicit balancing is an inappropriate judicial role, that the reasons of the public prosecutor for seeking termination of the action should be subject not to judicial review but rather only to public, political, and legislative review.

6 Institutional limitations on public enforcement

Much, but not all, of the analysis so far favours exclusive public enforcement of regulatory statutes on efficiency and other grounds. Thus, to some very substantial extent, the case for private prosecutions must rest on the inadequacy of public prosecution. As has been stated in the competition policy area in arguing for private action:

> Whatever the reason, competition enforcement has not been a very high priority of government, and departments responsible for securing compliance with the legislation have not been equipped sufficiently for the vigorous effort required in pursuing this objective ... The thesis of this report is that, for the foreseeable future, the public enforcement of the combines legislation will not reach optimum levels and that private damages litigation can contribute to the effort.[25]

In addition to the failure to bring sufficient resources to bear in public prosecutions it is also perceived that for many offences low fines have tended to be assessed even where convictions were achieved. The efficiency advantages of fines are dissipated if the courts fail to take advantage of their flexibility to impose deterrent penalties.

Therefore, if one believes that there has been and will continue to be a systematic failure on the part of governments to enforce their legislation

[25] See A Proposal for Class Actions Under Competition Policy Legislation (Information Canada: 1976), 48.

and a systematic failure on the part of the courts to impose adequate penalties, and that these failures cannot be remedied directly, a strong case is made for private enforcement. To discover why governments and courts fail in these ways is well beyond the scope of our analysis. However, their failure seems connected in part to the inherent limits of the criminal sanction as a means of economic regulation.

Another consideration favouring private enforcement may lie in the nature of the budgetary process. It may be politically more acceptable to obtain a single legislative amendment permitting private actions which have no perceived budgetary implications than to pass large annual enforcement budgets. Once passed, moreover, it may be more difficult to repeal or amend legislation than to reduce the enforcement budget, and thus the enforcement activity may be better insulated from political pressures.

7 Opportunities for abuse

It is often argued that one substantial disadvantage of private actions, particularly in class form, is that they create an opportunity and an incentive for abuse. This perception has led to the labelling of private class actions as 'legalized blackmail' and as 'strike' suits.[26] The objection is that the class action procedure allows the plaintiff to bring a claim lacking in merit simply to induce the defendant to make some payment to the plaintiff to settle the action and avoid further litigation.

To the (unknown) extent that there is a greater potential for abusive private actions than public actions this factor must be weighed against facilitating private actions, particularly in class form. On the other hand the mere fact that there will predictably be some improper or non-meritorious suits does not necessarily prove that there should not be class action procedures at all. Rather, it argues for a weighing here as elsewhere of the costs and benefits of the procedures. If it is thought that class actions may make a substantial contribution to the quality of law enforcement, then the fact that a few abusive or improper suits will be initiated should be accepted as a cost, but one outweighed by the benefits. Further, it argues for a careful design of the class action procedures themselves to minimize the opportunity for abuse without crippling the substantial portion of class actions likely to be extremely beneficial.

[26] See Handler, supra, note 2.

In considering the potential for abuse of private enforcement it is important not to ignore the analogous potential for abuse in public prosecutions. As stated above, the prosecutorial discretion accorded the public prosecutor where he enjoys an enforcement monopoly may be exercised on the basis of improper as well as proper considerations.

Implications: the public civil action

Perhaps the most important implicaton of the analysis above is the recognition that the strength of the case for class actions varies with the nature of the claim being asserted. In particular, the extent to which achieving compensation can be said to favour private enforcement varies with the magnitude of the individual claims involved. Therefore, our analysis suggests that the procedure for actions representing an aggregation of large individual claims should be different from that for actions gathering together many small claims.

For non-viable claims a procedural code should be developed with little emphasis on its ability to achieve compensation. On the other hand for individually recoverable claims compensation is a substantial objective, and any code must preserve these private rights of action. The emphasis of the code in these situations should be on litigating the claims in the most efficient manner possible by creating incentives for the plaintiffs to bring their claims together rather than acting individually. Individually non-recoverable claims present a more difficult issue because, although compensation is not irrelevant, the costs of proving and distributing it are likely to amount to a substantial portion of the costs of the enforcement action. Whether or not in a particular case the benefits of compensation outweigh the costs of achieving it is not easy to decide in advance. The line dividing those cases in which compensation is important from those in which it is not is likely to vary significantly with the complexity of the cause of action and the mechanisms by which compensation might be paid.

One substantial advantage of the private action is that it relies on a civil standard of proof and the complained-of conduct need not be characterized as criminal before it attracts a financial penalty in the form of damages. We have assumed so far that these advantages are available only in a private civil action and not to the public prosecutor, who could only resort to the traditional criminal action. However, this is clearly not inevitable. Indeed, there are precedents for creating a public civil cause of action, to be brought by public authorities but seeking damages rather than

a conviction. This is not to be confused with the Crown's suing civilly for damage to its own interests, which is of course a common form of action and generally indistinguishable from a normal private action. The public civil action to which we refer here is sometimes known as a parens patriae action, a suit brought as a civil action by the Crown to recover damages suffered by individuals within its jurisdiction. In this form of action many of the advantages of public and private enforcement can be combined, because all the advantages of public prosecution can be combined with two of the primary advantages of private enforcement: the civil standard of proof and the non-criminal characterization of the conduct.

The only important objective a public action may not be able to meet adequately is to have compensation determined and administered by a court. Therefore, in cases where the compensatory objective of the action is significant, in that the amount of damage suffered by each individual victim is substantial, the case for the private civil action in class form remains powerful. However, at least in the case of non-viable claims, and probably for the lower range of cases falling in the individually non-recoverable category, where compensation is not a significant objective, the public civil action appears to be the most desirable form of enforcement. Even in these cases, if it is thought that compensation should be paid at least to those individuals whose claims are not trivial, it is possible to imagine a scheme whereby the full damages award is paid to the Crown, with the Crown then creating a low-cost administrative process to distribute damages to those individuals coming forth with proof of entitlement.[27]

This procedure for compensation is likely to be more effective than judicial supervision of individual compensation because an administrative scheme with a bureaucratic structure could be more efficient than a court in dispensing small amounts of compensation to large numbers of individuals. If these claims did not exhaust the damages fund created by the defendant's liability, the remainder could be paid to the consolidated revenue fund without generating any of the difficulties associated with fluid class recovery schemes. Furthermore, a multiple damages provision could be included in the calculation of the defendant's liability to the Crown without creating perverse incentives since the compensatory entitlements of in-

[27] See the provisions of S. 3475 (supra, note 15). Indeed, the use of the public action to achieve compensation could be expanded to all claims, regardless of size, if it were desired. Certain corporations and securities statutes provide for this approach on a concurrent basis.

dividuals could be limited to the damages actually suffered. The difference between the multiple damages award and the actual claims could again be paid to the general revenue fund.

The creation of a public civil action for redress of relatively small individual claims does not determine the degree of prosecutorial discretion to be preserved in the public prosecutor. At one extreme the public prosecutor could be given the sole authority to initiate, pursue, and conclude by trial or settlement all these public civil claims. At the other extreme the claims would still be brought in the name of the Crown but could be initiated, pursued, and concluded by private prosecutors. In the latter model the private prosecutor would be rewarded by an appropriately calculated award of lawyers' fees plus perhaps some reward for discovering the violation and initiating the action (finders' fees).

Between these two extremes various schemes are possible. Perhaps the most appealing would be to base the scheme on the criminal prosecution model but add provisions for lawyers' and finders' fees.[28] That is, any individual would be able to initiate a public civil action in the name of the Crown (just as any individual can lay an information to initiate a criminal proceeding), but the public prosecutor would have the right, though not the duty, to intervene in the action. His intervention could take the form either of making representations to the court while the private prosecutor would continue to manage the action or of assuming full responsibility for the carriage of the action. To the extent the private prosecutor bears partial or total responsibility for the carriage of the action, appropriate compensation for legal fees would be required. In addition, a finder's fee calculated with some relationship to the damages recovered would be payable in all cases to encourage the identification of violators.

The advantage of this scheme is that it recognizes and provides for the ultimate authority of the public prosecutor in these actions while at the same time harnessing the initiative, information, and independence of private prosecutors. Thus, a healthy check on the public prosecutor can be achieved without undermining his ultimate authority for enforcement decisions.

As explained earlier, this public civil action is designed for situations where the individual claims being aggregated are not large enough that individual compensation can be seen as a dominant objective of the pro-

[28] Ibid.

cedure. In cases aggregating more substantial individual claims a mechanism more clearly focused on the compensatory goal is required. For this purpose the private class action with appropriately designed incentive provisions may be the most efficient and effective procedure. In these cases judicial and other prosecutorial resources can be conserved by creating a procedure which encourages the aggregation of the individual claims for a single determination binding on all the claims.

With regard to prosecutorial discretion in private class actions, a tradeoff must be made between the enforcement objective, which might favour locating the ultimate control of the actions with the public prosecutor, and the individual rights being asserted in the class procedure. Since by definition the individual claims in these actions are not insignificant (if they were, they would be pursued through the public civil action), it would in our view be inappropriate to allow concern for prosecutorial discretion to outweigh the individual rights. Therefore, the private class procedures should permit the public prosecutor to intervene to make known to the court his views on the desirability of the class action in the particular case, but unlike in the case of the public civil action he should not be given the authority to take over the claim or demand its termination. If the public interest is sufficiently threatened by a court's decision to permit the continuation of the class action in a particular case, remedial action to amend the substantive legal rule in question or provide other relief to the defendant should be undertaken by legislative act rather than the mere exercise of the prosecutor's discretion. Any provision giving greater authority to the public prosecutor than the right to intervene would likely cause potential class members to litigate their claims individually rather than as a class, thus replacing a single action with a multitude of claims.

The remaining question is how to draw the line distinguishing claims suitable for public civil actions from claims suitable for private class actions. In theory the distinction should be related not only to the size of the individual claims as a measure of the compensatory objective but also to the costs of achieving the compensatory objective through the judicial process. The magnitude of the compensatory objective may be roughly related to the likelihood that the individual claims would be litigated individually if the class procedure were unavailable. As such, the dividing line between the public and private actions could be drawn case by case, with the court being directed to make a preliminary assessment of the

suitability of the form of action in light of the factors identified above.

A simpler solution would be to draw the line at an arbitary dollar amount reflecting the compensatory objective.[29] While a blunt tool, such an approach would offer simplicity and certainty to both potential plaintiffs and defendants. It should also be remembered that those claims falling below the line and thus proceeding as public civil actions do not deny the possibility of individual compensation; they merely provide that compensation will be achieved through an administrative rather than a judicial process.

DESIGN ISSUES IN CLASS ACTION PROCEDURES

Introduction

If it were decided as a matter of policy that class actions should be assigned a more extensive role than in the past, at least in some areas of law enforcement, complex issues then arise of how to impart the correct incentives to the various actors in the litigation process to ensure that an appropriate number and kind of class actions are brought. For individually recoverable claims one may wish to facilitate class actions as a means of economizing on legal resources that would otherwise be wastefully consumed in processing individual suits. For individually non-recoverable claims one may wish to facilitate class actions for deterrent and compensatory reasons even though they create net additional demands on the legal system. The rationale for allowing non-viable claims as class actions must rest solely on deterrence grounds, with any recovery for the class accruing to the lawyer for the class, the state, or some other third party.

After roles have been delineated for public and private law enforcement mechanisms in a given area of substantive or regulatory law, and after a role has been defined for class actions within the private enforcement mode, we can identify those legal costs which are solely a function of litigating in class form and may constitute barriers to class actions. Of those costs that are peculiar to class actions one may wish to ask whether they can properly be reduced or eliminated. Of those costs which cannot be eliminated, the issue becomes who should bear them. If these costs are imposed on the representative class member in whose name a suit is brought, a classic externalities problem is created whereby one member of the class is left bearing all the costs or potential costs of bringing suit while the benefits of a successful suit will be shared by all

[29] This is the approach used in S. 3475.

members of the class. The failure to internalize all costs and all benefits in the class representative, as in the case of an individual claimant bringing an individual suit of the same aggregate amount, wil ensure that class actions are underused. Most design issues in class action procedures relate either to improving the technical efficiency of these procedures so as to reduce or eliminate special legal costs engendered by litigating in class form or to redressing the externalities problem created when the costs and benefits of class litigation accrue to different persons. We now examine each of the major cost barriers.

Barriers to suit

The major economic disincentives facing a class representative in deciding whether to lend his name to a potential suit all involve some form of transaction cost, just as in the case of non-class litigation. If litigation were truly costless for any plaintiff, he would in theory bring a suit in respect of a 10-cent claim with only a 10 per cent probability of success. But of course litigating is not costless, and apart from the personal time and effort entailed in lending one's name to a suit as a class representative other costs or potential costs are incurred. Some of these are out-of-pocket expenses or disbursements associated with meeting procedural requirements, such as providing notice to other class members of the pendency of the suit and the right to opt out. Individual class members may also face distribution costs in proving a right to a share in a common class recovery. Other possible costs faced by the class representative relate to the expense entailed in hiring a lawyer for the class and the risk of having to pay his legal costs if the suit fails.

1 Notice costs

Perhaps surprisingly, present Anglo-Canadian law on class actions does not require a class representative to give notice to other class members of the pendency of the suit on their behalf and their right to opt out if they wish. This right could be particularly important in the case of individually recoverable claims where potential class members may prefer to pursue their claims in their own right without risking prejudice in a class action over which they have little or no control. This consideration has limited relevance in the case of individually non-recoverable claims or non-viable claims, where by definition individual class members would not bring individual suit in the absence of a class action. In contrast to the Anglo-

Canadian notice rule, US class action law requires notice to class members, although there has been debate over the appropriate scope and financing of this requirement.[30] The notice issue is clearly one of the major design issues to be resolved in the reform of class action procedures.

If it is accepted that a notice requirement serves little purpose in the case of individually non-recoverable and non-viable claims, discussion can be narrowed to the case of individually recoverable claims. Here, while due process considerations militate in favour of a notice requirement, economic efficiency considerations tend to run in the other direction. If class actions should be facilitated in the case of individually recoverable claims as a means of economizing on legal resources that would otherwise be wastefully consumed in the processing of individual suits, the basic fact must be faced that by definition the class representative has the alternative of individual suit. Thus, to impose on him any notice requirement (without corresponding compensation) is likely to cause substitution to take place, even though, as we have assumed, an individual suit is less efficient than a class action as a means of resolving all the claims. If promoting efficient utilization of legal resources is a paramount objective in this context, a notice requirement must be dispensed with altogether or the costs of it shifted elsewhere, say to the defendant, the class lawyer (who might finance these costs on a contingency basis), or some other third party such as a state legal aid fund. In other words, because notice costs entail a private externality on the part of the class representative, they will often deter class actions that on other grounds it would be efficient to promote. It has been shown that in many cases suing in class form does not become economically more attractive than an individual suit unless the notice costs are borne by the class lawyer on a contingency basis rather than by the class representative.[31]

If notice requirements are largely abandoned, some other assurance must be provided to class members that they and their claims are being adequately represented. One possible form of such assurance is judicial supervison of the adequacy of representation, appropriateness of class definition, and so on, perhaps in preliminary certification proceedings.

30 See Dam, 'Class action notice: who needs it?' (1974), Sup. Ct. Rev. 97; Note 'Developments in the law - class actions,' 89 Harvard L. Rev. 1319, at 1402ff (1976).

31 Dewees, Prichard, and Trebilcock, 'An economic analysis of cost and fee rules for class actions,' University of Toronto, Law and Economics Workshop, 28 March 1979, Table 4.

Probably more crucial is the incentive structure facing class lawyers to accept or reject class action retainers and to allocate an appropriate amount of resources to the suit thereafter. In other words, either the courts, through judicial supervision, may assume a central quality-control responsibility or the lawyer for the class may, by appropriately fashioned incentives, be looked to as a private quality-control agent. We discuss the role and incentives of the class lawyer further below.

2 Distribution costs

Assuming that a class action has been successful and a judgment for compensation given in favour of a class, class members will still face the costs of coming forward individually to prove a claim to a share in the common recovery. Present Canadian class action rules regard this as the only permissible form of distribution of a common class recovery.

The existing rules prevent class actions being brought in many cases because of the difficulty of proving individual claims to a share in the common recovery. Three broad policy alternatives appear to be available: first, to abandon the compensation objective where an individual proof and compensation requirement cannot economically be met and provide instead for a public civil action, perhaps privately initated, where the recovery is not distributed to the aggrieved class members but instead accrues to the state, thus serving only a deterrence objective; second, to provide an alternative means of distribution such as the fluid class recovery where a court is empowered to make orders for the application of the unclaimed portion of the common recovery to such attainable purposes as seem best to promote the compensatory objectives of the suit, such as an application of unclaimed damages to hospital and health care amenities in a successful consumer class action for price fixing by drug companies; third, to provide a lower-cost administrative form of distribution after class damages have been paid to the state.

3 Legal fees

Legal costs pose special problems for class actions. Existing Anglo-Canadian rules produce the following results. If a class action succeeds, the class representative, while of course not liable for the other side's legal costs, remains liable for that portion of the legal costs of the class not indemnified by the defendant (i.e. the difference between solicitor and client costs and party and party costs) and is not entitled to a contribution from other

members of the class. If his own claim is relatively small it will not be worth pursuing in the face of this prospect. If the class action fails the class representative will become liable for two sets of costs: the legal costs incurred by the class and the legal costs of the defendant. These rules operate as daunting disincentives to the bringing of class actions.

Recent class action amendments proposed to the Combines Investigation Act (Bill C-13) contemplate in effect a no-way rule (each side bears its own costs) instead of the usual two-way costs rule (the winning side is indemnified for some or all of its costs by the losing side); in the event of a successful suit the amendments would permit the lawyer for the class to collect his reasonable solicitor and client costs pro rata from all members of the class as a first charge on the common recovery.

This proposal appears not to grasp fully the risks faced by a class representative and his lawyer. If the suit succeeded the lawyer would be assured reasonable solicitor and client costs from the class for his services. But if it failed he would not be entitled to receive his fees from the other side and could only look to the class representative for payment. Few class representatives will accept this risk. Understandably, few lawyers will accept the risk of non-payment either. Given the complicated and time-consuming nature of most class actions and the uncertain outcome of such actions in areas of complex economic regulation such as competition policy, the risk of failure, whether borne by the class representative or by the lawyer, will deter most suits. It has been shown that simply adopting a no-way cost rule will not significantly reduce the barriers to class litigation except for individually recoverable cases.[32]

Two alternative 'private' (non-subsidized) solutions, both involving contingent fee components, might be considered. The first would be to retain the traditional two-way costs rule, which is economically sound because it ensures that the losing party bears the full costs inflicted by his conduct on the other party, but with the following modifications. If a class action succeeded, the class would recover its damages and its lawyer his costs from the defendant, those costs reflecting the value of his time invested in the suit multiplied by a factor to compensate him for the risk of non-compensation in the event of the suit's having failed. If the suit instead failed, the lawyer for the class would have no claim for costs against the class or its representative, and he might be made personally

[32] Ibid., Tables 4-7.

liable for the defendant's costs (to discourage unmeritorious suits), thus freeing the class or its representatives from any such liability. The compensation received by the lawyer for the class in successful suits must of course reflect the risk of this liability.

The second alternative would be to adopt the no-way costs rule proposed in Bill C-13 but provide for compensation to the lawyer from the class fund in successful suits on a basis which reflects the risk of non-compensation in the event of an unsuccessful suit, where no costs would be recoverable (to discourage unmeritorious suits). This is essentially the present American rule.

The advantage of the second alternative over the first is that it reduces the variance in risk faced by the lawyer for the class by removing liability for the defendant's costs in the event of an unsuccessful suit and reducing his cost recovery in successful suits accordingly. In relatively small legal markets such as exist in Canada the limited volume of class actions may prevent desired diversification of risks by legal firms through the spreading of risks across a number of suits. The advantage of the first alternative over the second is that it faces a defendant, if liable, with the full social costs of his misconduct, and a plaintiff, if unsuccessful, with the costs he has unjustifiably inflicted on the defendant. By manipulating the multiplier applied to the value of the lawyer's time under either alternative, perhaps by regulation, government could very simply regulate the volume of class actions.

It has been shown that both of the alternatives just described can significantly lower a barrier to class litigation without unleashing a flood of non-meritorious claims.[33]

Contingent fee arrangements are at present prohibited in Ontario. The subject arouses strong passions. On one hand it can be argued that throughout our economy there exist specialized risk-bearers, such as insurance companies, mutual funds, and manufacturers through product warranties, offering to assume risks - at a price - that other people would prefer not to bear. By specializing in risk-bearing these firms are able to diversify away some of the risks assumed in a way that the individual risk-bearer is commonly unable to do. The lawyer under a contingent fee arrangement is performing much the same function. In return for the prospect of a higher fee in the event of a successful suit, he agrees to absorb

[33] Ibid.

all his own costs (and possibly the defendant's costs and notice costs) in a losing suit and absolve his client from them. On the other hand it is argued that contingent fee arrangements are open to abuse. For example, lawyers may have stronger incentives to settle suits so undertaken on terms very favourable to themselves but highly disadvantageous to their clients. Also, lawyers will typically be much better placed than their clients to assess the risks entailed in bringing suit and to take advantage of their clients' relative ignorance in entering a contingent fee arrangement. Judicial supervision of settlements or fee levels may be at best an imperfect check on such abuse.[34] However, the weak incentives for class representatives and class members to monitor their lawyers' performance pose problems not peculiar to contingent fee arrangements.

If a contingent fee approach to the problem of overcoming legal cost disincentives to bringing class actions were unacceptable, the broad alternative approach would be a 'public,' subsidized, response to the cost barriers. This is the direction followed in the Quebec Class Action Bill (Bill 39, 1978),[35] where a special public fund is set up out of which class actions may be subsidized. While this approach might be an improvement over the current system, it does present difficulties. First, the funding agency is given a very poorly chartered discretion, the exercise of which is likely to involve it in considerable controversy (the spectre of a trial within a trial), because very often its decisions will mean life or death to a proposed class action. Second, there is no clearly articulated theory of why public subsidization of this class of non-means-tested litigant can be socially justified.

Class actions as 'legalized blackmail'[36]

One of the most persistent and trenchant criticisms of class actions is that they are a form of 'legalized blackmail' allowing class representatives and

[34] For economic analyses of contingent fee arrangements, see Schwartz and Mitchell, 'An economic analysis of the contingent fee in personal-injury litigation,' 22 Stanford L. Rev. 1125 (1970); Clermont and Currivan, 'Improving on the contingent fee,' 63 Cornell L. Rev. 529 (1978).

[35] See also the Ontario Task Force on Legal Aid (the Osler Task Force), Ministry of the Attorney General, Ontario, 1974, Chapter 11.

[36] For contrasting views, compare Handler, 'The shift from substantive to procedural innovations in antitrust suits,' 71 Columbia L. Rev. 1 (1971); Landers, 'Of legalized blackmail and legalized theft: consumer actions and the substance procedure dilemma,' 47 S. Calif. L. Rev. 842 (1974).

class lawyers to exact unjustified settlements from class defendants.

Though the charge has typically been loosely made, there appears to be some substance to it. First, to the extent that class actions promote purely deterrent and not compensatory objectives (i.e. non-viable suits), critics who believe such an objective is inappropriate for a private law suit may view such actions as an illegitimate form of private coercion. Second, to the extent that class members or class lawyers are able to manipulate the selection of a class representative to ensure that he is judgment-proof in the event of a losing suit and an adverse costs award, parties bringing an unmeritorious class action may have an ability to inflict, or threaten to inflict, substantial and non-recoverable legal costs on the defendant, the desire to avoid which may induce unjustified settlements. Third, the combination of the large amounts of money involved and the large number of allegedly aggrieved parties entailed in many class actions may generate false signals to the public by inducing unjustified identification or association with the grievances asserted by the class. In view of the extensive coverage the media are often likely to attach to large lawsuits, corporate defendants will often feel under pressure to settle in order to foreclose a flow of adverse publicity that may well continue throughout the typically lengthy course of most class action litigation. Fourth, all other things equal, class actions may be more likely to involve claims with a low probability of success than individual suits for the same aggregate amount. In the latter case litigants will often tend to be business or institutional parties engaged in continuous dealings, where litigation is invoked only as a last resort in dispute resolution. The constraint of continuous dealings will apply less frequently to most types of class actions.

There is thus some force to the notion of blackmail. Meeting this objection adequately is not an easy matter. Requiring preliminary certification by a court might ensure that clearly unmeritorious claims are terminated soon after filing, although in this case the initial filing would not, and could not, be precluded. Beyond judicial oversight in preliminary certification proceedings, the best assurance against unmeritorious suits being brought to induce unjustified settlements from class defendants may be to face the lawyer for the class personally with the costs associated with the dismissal of such a suit at the certification stage or thereafter. It will be recalled that the first variant on the contingent fee proposal discussed above would substantially achieve this objective. If dismissal were to happen only rarely its occurrence might help discourage oppressive suits. Moreover

by applying a conservative multiplier to the value of a lawyer's time when undertaking a class action on a contingent fee basis, the incentive to undertake highly speculative suits could be tightly circumscribed. Any residual potential for abuse left unresolved by such constraints must be weighed against the potential abuses of prosecutorial discretion in public enforcement. In neither case is the mere potential for abuse a decisive argument against that mode: it is simply another factor to be included in the choice.

The concern over class actions as blackmail has arisen primarily under the US rules allowing contingent percentage fees. It has been shown that under certain circumstances this fee arrangement may lead both the class representative and his lawyer to be willing to sue even though they have a very small chance of winning: sometimes less than 10 per cent.[37] The contingent hourly fee discussed above is quite different. Under the same circumstances it does not lead to low-probability suits being brought. Thus, the risk of blackmail under a contingent hourly fee arrangement is substantially less than under the contingent percentage fee.

The lawyer as an entrepreneur of law enforcement

The traditional model of the lawyer-client relationship depicts the lawyer as an agent sought out, retained, instructed, and monitored by a client who has recognized for himself that he faces an existing or potential legal problem. However, this model is not an accurate description of the relationship between a lawyer and his client in a class action involving a large number of relatively small claims. It is not plausible that an individual with a claim of $100 will hire a lawyer and bring a $2 million class action simply to recover his $100. The lawyer, not the class representative, has the real economic interest here.

A change to an entrepreneurial role for lawyers is inherent in a private enforcement mechanism for cases in which the potential recovery of individual plaintiffs or class members is small in relation to the legal costs. If policy seeks to promote class actions of this kind the incentive structure facing a prospective lawyer for the class becomes a critical issue. In many class action situations the class lawyer can only realistically expect to be paid if the suit succeeds. It is unlikely that he will be able to look to the class representative for payment if the suit fails, and he has no right at

[37] Dewees, et al, supra, note 31.

present to seek payment from the class members at large. Moreover, such a right would often be of little value because of the transaction costs entailed in enforcing a costs claim against individual members of a large class. Thus, for better or worse, class actions in many cases must be undertaken if at all, on a contingent fee basis, giving the lawyer a direct stake in the outcome of the action.

Beyond fee arrangements, the entrepreneurial role played by lawyers in much class action litigation has other implications. In particular, present prohibitions against maintenance and champerty ('fomenting' or financing litigation) would need to be abrogated in situations where this form of private enforcement was desired. Also, current prohibitions against advertising and other forms of solicitation of clients by lawyers would require modification in a class action context. If law enforcement policy contemplates a positive role for private law enforcement through the class action mechanism, those persons most capable of identifying violations of the law should be encouraged to do so and to take action to prevent the offensive conduct.

Often lawyers will be in the best position to make this identification of offences, but because a private action requires 'victims' as the representative plaintiffs the lawyer must be able to solicit a client in order to act as a private enforcer. In class actions the typicality of the class representative's claim may be an important factor, and the class lawyer will want the legal ability to canvass potential class members to satisfy himself of this. In addition, circumstances may demand a solicitation to provide for reimbursement of expenses if permissible contingent fee arrangements do not extend to disbursements. Further, the class lawyer may sometimes wish to communicate with potential class members to establish the availability of evidence, the acceptability of settlement proposals, and so on. Clearly the problems posed by a lawyer's role in class action litigation, such as solicitation, must be squarely confronted and realistically resolved if class actions are to play a significant role in a wider law enforcement policy.

CONCLUSIONS AND AGENDA FOR DISCUSSION

The following conclusions and issues for discussion can be drawn from our analysis. Though phrased as general propositions, they should be sufficiently precise to mark the crucial points in the reform of class action procedures.

Objectives of law enforcement

1 A primary goal of law enforcement, whether by public prosecution or private lawsuit, is to reduce the amount of wrongful activity: to deter wrongdoing. Because of cost the ideal or optimal deterrence is not complete deterrence. Instead, the goal should be to minimize all costs associated with the wrongful activity, including the cost to the wrongdoer of reducing that activity, the damage done to the victim, the victim's cost of avoiding damage, and the public and private costs of imposing deterrence, including surveillance costs, legal fees, and court costs for both plaintiff (or prosecutor) and defendant.

2 Private actions can contribute to the optimal enforcement of law from a deterrence perspective while at the same time achieving compensation for victims of wrongful activity. As a mechanism aggregating numerous individual claims into a single action, the class action is potentially an efficient enforcement device. At the same time, however, private actions should be viewed as substitutes for public enforcement actions, so that the relative merits of the two types of action must be considered.

Private versus public enforcement

1 An assessment of private and public enforcement reveals that the primary advantages of private enforcement are the sometimes superior ability to detect offences, the change from criminal to civil liability with a consequent lessening of the standard of proof, the potential compensatory contributions of a civil action in cases involving significant individual losses whether they are recovered in individual or class form, a check, though not a costless one, on abuses of the public prosecutor's discretion, and the possibility of relief from systematic public underenforcement of regulatory statutes.

2 Private prosecution should not be looked to as a panacea for achieving optimal levels of enforcement, because it faces a number of difficulties. The determination of the damages payable in a civil suit is likely to be more complex than the assessment of a fine. The 'perverse incentive' problem limits the desirability of using multiple levels of damages to reflect the fact that the probability of enforcement is often less than certainty. Fluid class recovery schemes may cause inequities and inefficiency. Finally, cases of both underenforcement and overenforcement may arise where the incentive structure facing private enforcers is relied on to achieve optimal levels of enforcement.

3 In assessing the relative merits of private and public actions a key

variable is the magnitude of the compensatory objective. With individually recoverable claims, compensation is a dominant objective. By definition the claims will be individually litigated if class procedures are not made available. Therefore, for these cases class actions are potentially a device for reducing the resources devoted to litigation.

4 In the case of non-viable claims, compensation is by definition unachievable. Therefore the entire argument for bringing actions in this area must rest on their contribution to the deterrence objective of law enforcement, a situation in which the public civil action may be a more efficient enforcement mechanism.

5 With individually non-recoverable claims, compensation is achievable but is not as substantial an objective as in the case of individually recoverable claims. Therefore, the costs and benefits involved in achieving compensation through the judicial process by means of a private class action must be assessed. In view of the relative efficiency advantages of public enforcement and the ability of a public civil action to achieve compensation through the administrative process, it would appear that only for larger individual claims, and thus in the upper range of the individually non-recoverable category, do the benefits of the private class action outweigh its costs relative to other mechanisms. Therefore the cases in the upper range might be treated in the same way as individually recoverable claims (private class actions), while the cases in the lower range might be treated in the same way as non-viable claims (public civil actions). The actual monetary line drawn between claims brought as private class actions and those brought as public civil actions should ideally reflect not only the size of the individual claims as a measure of the compensatory objective but also the costs of achieving compensation through the judicial process.

Substantive areas where class actions might be appropriate

1 The desirability of private enforcement generally and class actions in particular is likely to vary with the nature of the substantive claim being asserted. For each area of substantive regulation it is necessary to apply the framework of analysis developed above to determine the relative effectiveness of public and private enforcement.

2 In light of this dependence on the nature of the substantive claims, a general across-the-board procedure facilitating class actions is unlikely to have unambiguously desirable effects. While such a procedure may produce numerous efficient actions, it is also likely to permit private class actions in

some cases where a form of public enforcement would be more efficient.

3 At the same time, however, the creation of improved class action procedures is unlikely to be enough to allow private enforcement to make its maximum contribution to optimal enforcement. It is also necessary to examine the substantive regulatory schemes to determine if new private civil causes of action are needed in some areas in order to attract private enforcement.

Class action design issues

1 If it were to be decided, as a matter of public policy, to facilitate class actions on a wider scale than is permitted under existing class action rules in Ontario, major cost barriers to suit in class form would have to be lowered, eliminated, or shifted.

2 In the case of the costs that would be faced by a class representative in meeting a requirement that notice of the pendency of the suit and the right to opt out be given to individual class members, several alternatives might be considered: one would be to eliminate a notice requirement for non-viable and individually non-recoverable claims, where individual class members are not prejudiced by the absence of notice because no alternative means of enforcing their claims is open to them; another would be for individually recoverable claims to eliminate a notice requirement, or shift the burden of it to some party other than the class representative, perhaps to the class lawyer, who might finance it on a contingency basis or subsidize it out of public funds.

3 In the case of non-viable claims, where the distribution costs will deter individual class members from proving a right to share in the common recovery, three alternative solutions might be considered: fluid class recovery, where the court is empowered to order some approximate form of compensation; abandonment of any compensatory objective by providing that the common recovery becomes the property of the state; or having the state provide a low-cost administrative machinery for distribution of individual entitlements.

4 As for the distinctive effects of the legal costs incurred by a class representative, which are especially acute in losing suits where the costs of both the class and the defendant must be met, three alternative solutions might be considered: a two-way contingent fee rule, in which the lawyer for the class in a losing suit would bear the loss of his own time and personal liability for the defendant's costs, with compensation in a winning suit fixed at a level to reflect these risks; a no-way contingent fee rule, which would

allow recovery by the lawyer for the class in a winning suit out of the common recovery (on a contingency basis) while he would bear the loss of his own time in a losing suit, with neither side liable for the other side's costs; or subsidization of the legal costs of the class out of public funds. The contingent fees suggested here are based not on a percentage of the final award but on the lawyer's effort and the costs he bears.

5 To minimize the potential for abuse of class action procedures ('blackmail' suits), consideration might be given to compelling class actions to prove prima facie merit in preliminary proceedings; to imposing liability for the defendant's costs in losing suits on the lawyer for the class; and to applying a conservative multiplier to the value of the class lawyer's time where contingent fees are employed, to discourage highly speculative suits.

6 In recognzing that the lawyer is an entrepreneur of law enforcement in many class actions and often has the most substantial economic interests at stake, special attention is required in formulating rules governing his role in, for instance, the financing of law suits, the investigation of potential causes of action and the solicitation of potential clients, communications with class members, and settlements.

Dewees, Donald N.

Class actions as a regulatory instrument.

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